COVERING SECRET

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FROM: P WYNN OWEN AND
D MCSHARRY
DATE: 9 JANUARY 1984

MR CASSELL

cc: as on attachment

MONTHLY FINANCIAL MARKETS REPORT

We attach a report on the financial markets in banking and calendar December, which is the joint work of HF and EF.

2. The list of copy recipients is attached. It is essentially, a list of those people who receive HF's monthly monetary report, since it replaces some of the material that used to appear as on Annex to the report. If anyone wishes not to receive this report on a monthly basis, or has any suggestions of anyone else who should receive it, could they please let us know.

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MONTHLY FINANCIAL MARKETS REPORT

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Sir T Burns
Mr Littler
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Mr King
Mr McSharry
Mr Blower

Mr Turnbull - 10 Downing Street, SW1

FINANCIAL MARKETS IN BANKING AND CALENDAR DECEMBER

SUMMARY

- The dollar rose sharply against all currencies in December, reaching all-time highs against a number of European currencies including sterling ($1.4100 on 14 December). Sterling traded steadier in the latter part of the month as expectations of a fall in oil prices eased.

- The money markets were quiet throughout the period, but with some firming of Eurodollars and period interbank rates in the first half of calendar December. These shaded down again towards the New Year as the market took on a more stable and quieter tone.

- In the Gilts Market the largest transactions tended to be redemptions and calls on part-paid stock sold previously. Nonetheless, the Authorities made three issues (amounting to £1 billion nominal) and announced a further £600 million of stock at the end of the year.

- The FT index rose by over 50 points between mid-November and the year end. Notable features were the undersubscription of the Cable and Wireless offer and the lengthy battle to takeover Eagle Star, which ended in an expensive victory for BAT.

- The Autumn Statement, right at the start of the period, was greeted quietly by the markets, since the upward revision in the PSBR had been discounted.

INTRODUCTION

Throughout the period from mid-November to end-December money and gilts markets were fairly stable despite increasing world political tensions. Sharp increases in US interest rates and the dollar contributed to some firming in short term interest rates in the first half of calendar December. Towards the New Year financial markets returned to a more stable and still quieter state, due to the festive season, some easing of concern about oil prices, a slightly quieter dollar and some signs of softness in US rates.

Spot Sterling

Trading in sterling was generally active in the latter part of November. Initial selling pressure from the US on the 18th and 21st and the larger than expected trade deficit for October (current account: -£200 million) together with easier spot on prices towards the end of the month caused the rate to ease from $1.4788 and 83.9 in effective terms on the 17th to 1.4664 and 83.1 at the close on the 30th.

	$/£	DM/£	£ Effective
1 December (open)	1.4642	3.9441	83.0

Sterling opened the month on a softer tone as weakening oil prices coincided with a general strengthening of the dollar to depress the rate.

8 December (close)	1.4417	3.9459	82.5

The pound held up better than most currencies after the dollar surged on the 5th, closing at 83.1 and DM 3.97½. Sentiment changed, however, following the news that the Soviet Union had cut its oil price and sterling met some widespread commercial selling on the 6th which caused the rate to fall to a low point of $1.4432 during the morning before recovering to $1.4500 at the close. Further sizeable selling late on the 7th, which continued in the Far East on the 8th, on worries about the outcome of the OPEC meeting pushed sterling to a low of $1.4345 and 82.2 before short-covering in London aided a recovery to $1.4422 and 82.5 in the afternoon.

14 December (close)	1.4185	3.9207	81.8

As the dollar stengthened further on the 9th following Regan's comments on interest rates, sterling eased to $1.4305 during the morning but news during the afternoon that OPEC had left production quotas and prices unchanged helped the pound to recover slightly to $1.4369 and 82.6. Sterling encountered widespread selling following the close on the 12th and again on the 13th particularly after rumours of a possible cut in BNOC oil prices in the New Year. These rumours, coupled with a further dollar surge on the 14th, caused sterling to fall to a record low against the dollar of $1.4100. However, the BNOC announcement later in the day proposing unchanged oil prices and a slight easing of the dollar enabled the pound to recover to $1.4185 with the effective index at 81.8.

30 December (close)	1.4520	3.9516	82.9

Sterling traded slightly firmer on the 15th, rising to $1.4257 at one point, as the market became more confident that oil prices would hold up. Markets were generally much quieter in the second half of the month as many dealers began to square their books for the end of the year. Sterling moved steadily upwards towards the end of this period, on reports that several major oil companies were supporting unchanged North Sea oil prices and met some demand as spot oil prices firmed.

The dollar

The dollar fluctuated sharply between 17 and 30 November as a variety of factors emerged to influence trading. After rising to DM 2.7210 at the close on the 29th following news of corruption charges against the West German Economics Minister Lambsdoff and his predecessor Friderichs, the dollar fell sharply on the 30th in reaction to the larger than expected $8.79 billion US trade deficit for October. The dollar strengthened sharply during December, rising from DM 2.6925 at the beginning of the month to a ten-year high of DM 2.7792 on the 16th as well as reaching record levels against other European currencies including sterling ($1.4100), the French franc (Ffr 8.4865) and the lira (1682). Renewed fears of higher US interest rates in view of the continued strength of the US economic recovery and the dollar's attraction as a safe haven currency in the face of international tensions were the main factors behind the dollar's rapid ascent. However, at the end of December, evidence emerged that the US recovery might be slowing and this together with other indications that US interest rate pressures were easing, led to a sharp fall in the dollar in thin trading which closed on 30 December at 2.7215.

Other currencies

Since mid-November the Belgian franc has remained firmly established as the weakest currency in the EMS, with the French franc, Irish punt, Dutch guilder and Danish krone alternating at the top. The narrow band remained at or close to its $2\frac{1}{4}$ per cent limit. The yen held up better than most against the stronger dollar during December, only temporarily losing ground following the ruling Liberal Democratic Party's poor showing in the Japanese general election.

Money markets

Banking December began quietly on November 17 with money market rates quite stable. The Chancellor's Autumn Statement the same day met little response in the money markets, which continued along a sluggish path (see attached table). After several weeks of market rumours about possible reductions in interest rates the tide began to turn towards the end of calendar November, possibly due to expectations of disappointing US and UK money figures in early December, concern about the exchange rates and nervousness about the oil price .

As the dollar began to firm against sterling in early December there was a sharp rise in Eurodollar rates and increasing nervousness in the domestic money markets with firming in shorter money rates. In particular, twelve month interbank rates rose into double figures and closed on December 16 at $10^{3}/_{16}$, while three month interbank rates rose ¼ over the first two full weeks of December to $9^{9}/_{16}$. Despite firm US rates and repeated record lows for sterling against the dollar, however, the market remained fairly quiet and the Bank of England's dealing rates were unchanged. Activity in the markets almost disappeared in the week or so before Christmas and the pre Christmas US Bond auctions, which implied slightly lower rates, led to some easing in the UK. When some dealers returned for the few days between Christmas and the New Year there were signs of a more confident, stable attitude to the prevailing rates.

The Gilts Market

The market was fairly soggy throughout most of the period under review. With previous low coupons having sold out, £½ billion of a new low coupon conventional, 2½ Exchequer 1986, was issued on 24 November. It came in for some criticism in the press, but was quite well received by the market, where it helped to attract funds after the Financial Secretary's statement of 17 November on offshore funds. By end-December less than £50 million nominal of 2½ Exchequer 1986 remained in the Issue Department. A very quiet calendar December was marked by a large redemption on 14 December and a couple of sizeable calls on part-paid stocks sold earlier. The Bank announced the issue of two conventional tranchettes of medium stock on 7 December - £300 million of 10¼ per cent Exchequer 1995 and £200 million of 10½ per cent Exchequer 1997 - which both sold out by the end of the year. Otherwise, the level of gilt sales was fairly low, with little or as market arising for some of the stock held by the Authorities, most notably the 2½ per cent Index-Linked 2020.

Yield curves in banking December rose by between a ¼ to a ½, but the final weeks of calendar December saw them shade down a little again, with most closing less than a [illegible] up on their mid-November level. Over the period as a whole, the shape of the curve remained largely unchanged. Indexed gilts saw very little trading activity and prices languished. The end-year announcement of a new IG further depressed prices a little.

RECENT GILTS ISSUES

Stock	Date Announced	Issue Price	Gross Yield to Redemption	£m Total amount
2½% Exchequer 1986	21/11	84½ minimum	8.46	500
10¼% Exchequer 1995	7/12	$101^{1}/_{8}$	10.67	300
10½% Exchequer 1997	7/12	$102^{7}/_{8}$	10.53	200
3% Treasury 1986	29/12	89	8.19	100
3% Treasury 1987	29/12	$83^{8}/16$xd	8.59	200
2% Index-Linked 1990	29/12	91	3.63	300

Finally, on 29 December, following the announcement of the exhaustion of the previous low coupon stock and the implementation of the new regime for offshore funds, the Bank announced a package of £600 million nominal of stock for issue early in the New Year, half of it comprising of two short tranchettes of conventional stock and half of a new 2 per cent Index-Linked 1990 stock.

The Equity Market

The FT 30 Share Index closed at 722.8 on Wednesday 16 November. Equities advanced towards the end of November helped by Courtaulds excellent interim results. US demand continued for ICI, while Eagle Star advanced as the rival bidders outmatched each other (Allianz has now withdrawn and BAT's final bid is £7 a share). At the tender on Friday 2 December the offer for sale of Cable and Wireless was undersubscribed. Early in December the market gained further ground and the 30 Share Index broke through the 750 barrier. Particular interest was shown in the financial sector, with discount houses and merchant banks in strong demand. The 30 Share Index stood at 775.7 at 30 December, having touched a high of 776.2 on 22 December. It stood at 596.7 a year ago.

Capital Issues

The net amount of new money raised by UK listed companies on the stock market in calendar December was £3 million, the lowest figure in the year. Total net issues by UK listed companies for 1983, however, were at the record level almost of £2.8 billion. With redemptions at £124 million, net issues were only £20 million. Gross capital issued by industrial and commercial companies were £42 million, including the first instalment (10) of a £40 million loan stock placing by ELK UK. Three financial companies raised money by rights issued. Of the overseas issues, the most notable was the Kingdom of Spain raising £15 million as the first instalment of a £50 million loan stock issue.

SECRET

	Band 1	Band 2	Band 3	Band 4
Dealing Rates (unchanged throughout period)	$9\frac{1}{16}$	9	$8\frac{15}{16}$	$8\frac{7}{8}$

Eligible Bill Rates	**Band 1**	**Band 2**	**Band 3**	**Band 4**
November 16 (close)	$9\frac{5}{64} - \frac{1}{16}$	$9\frac{1}{16} - 9$	$8\frac{15}{16} - \frac{59}{64}$	$8\frac{7}{8} - \frac{55}{64}$
December 2 (close)	$9\frac{1}{16} - 9$	$9 - 8\frac{63}{64}$	$8\frac{61}{64} - \frac{59}{64}$	$8\frac{57}{64} - \frac{7}{8}$
December 16 (close)	$9\frac{1}{16} - 8\frac{7}{8}$	$9\frac{1}{64} - 8\frac{63}{64}$	$9 - 8\frac{31}{32}$	$9\frac{1}{32} - 8\frac{31}{32}$
December 30 (close)	$9\frac{1}{16} - 9$	$9 - 8\frac{63}{64}$	$8\frac{15}{16} - \frac{59}{64}$	$8\frac{7}{8} - \frac{55}{64}$

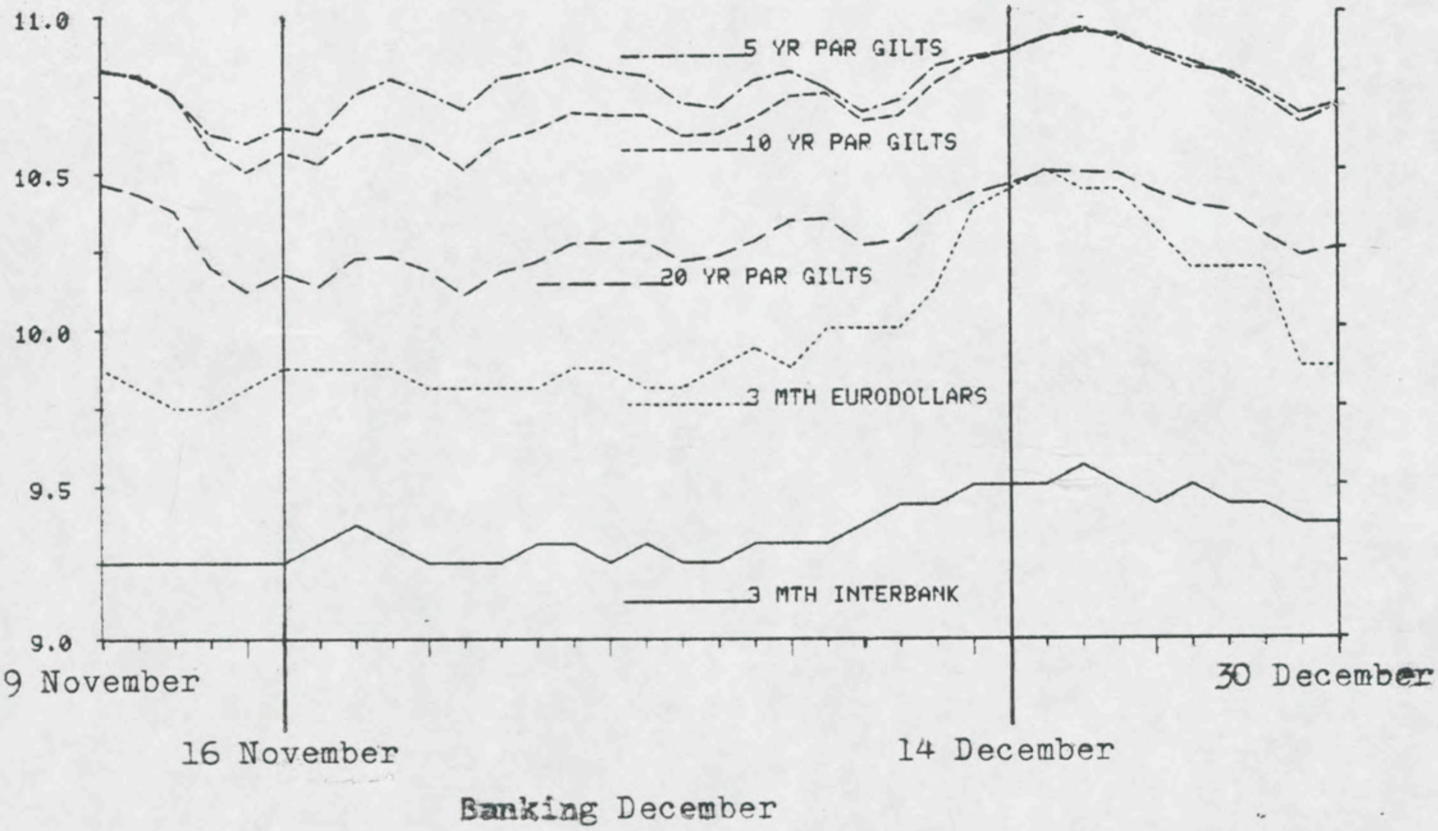
Interbank Rates	**7 days**	**1 month**	**3 months**	**12 months**
November 16 (close)	$9\frac{1}{8}$	$9\frac{1}{8}$	$9\frac{1}{4}$	$9\frac{5}{8}$
December 2 (close)	$9\frac{1}{16}$	$9\frac{1}{8}$	$9\frac{5}{16}$	$9\frac{7}{8}$
December 16 (close)	$8\frac{15}{16}$	$9\frac{3}{16}$	$9\frac{9}{16}$	$10\frac{3}{16}$
December 30 (close)	$9\frac{3}{16}$	$9\frac{3}{16}$	$9\frac{3}{8}$	$9\frac{13}{16}$
Eurodollar Rates				
November 16 (close)	$9\frac{1}{2}$	$9\frac{9}{16}$	$9\frac{7}{8}$	$10\frac{1}{4}$
December 2 (close)				
December 16 (close)	$9\frac{13}{16}$	$10\frac{1}{2}$	$10\frac{7}{16}$	$10\frac{15}{16}$
December 30 (close)	$9\frac{11}{16}$	$9\frac{3}{4}$	$9\frac{7}{8}$	$10\frac{7}{16}$

International Comparisons Closest analogies to 3 month interbank rates:

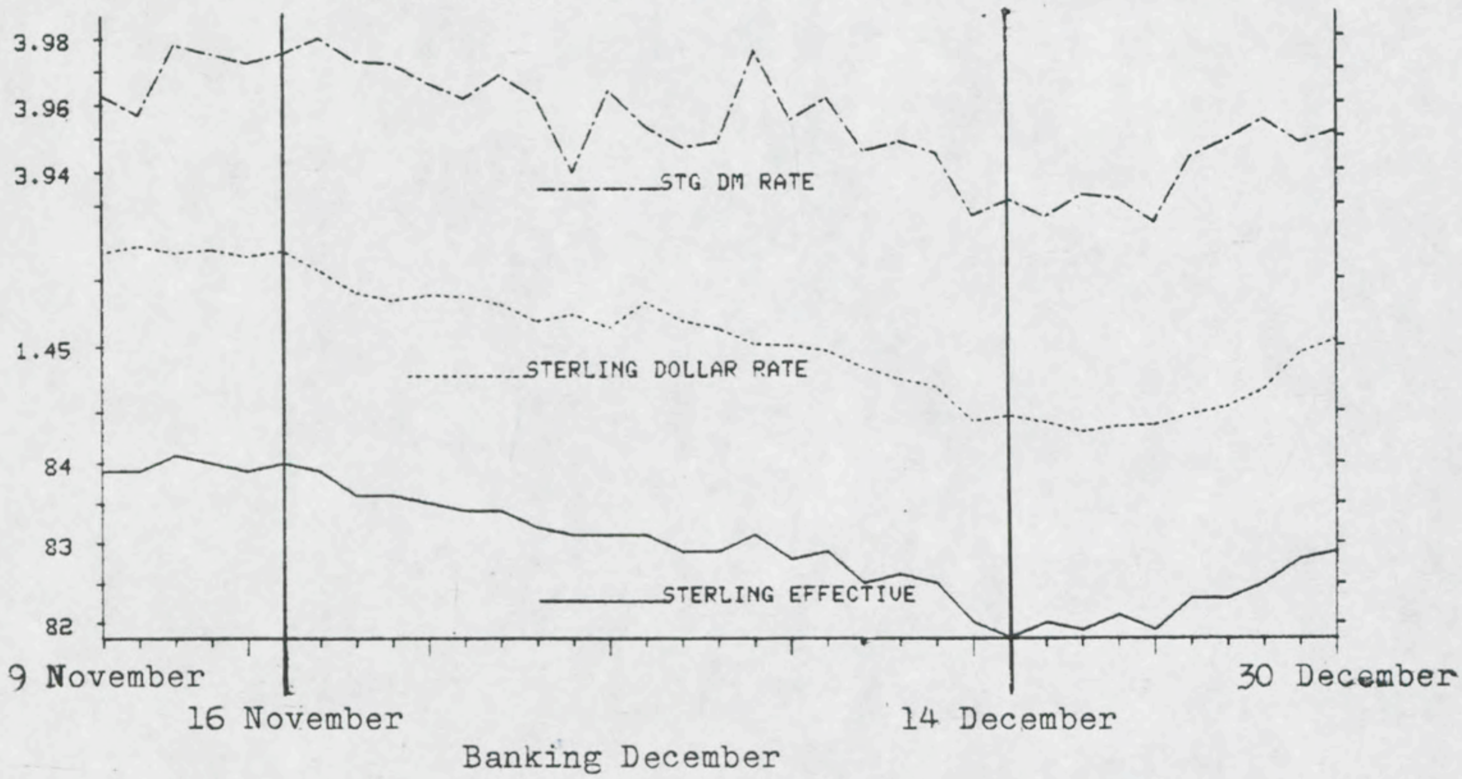
Week starting	**USA**	**Germany**	**Average 6 leading OECD (batting UK)**	
Nov 21	9.4	6.3	10.2	
Nov 28	. 9.3	Na	10.3	)
Dec 5	9.5	Na	10.4	) Approximate
Dec 12	9.6	Na	10.4	)

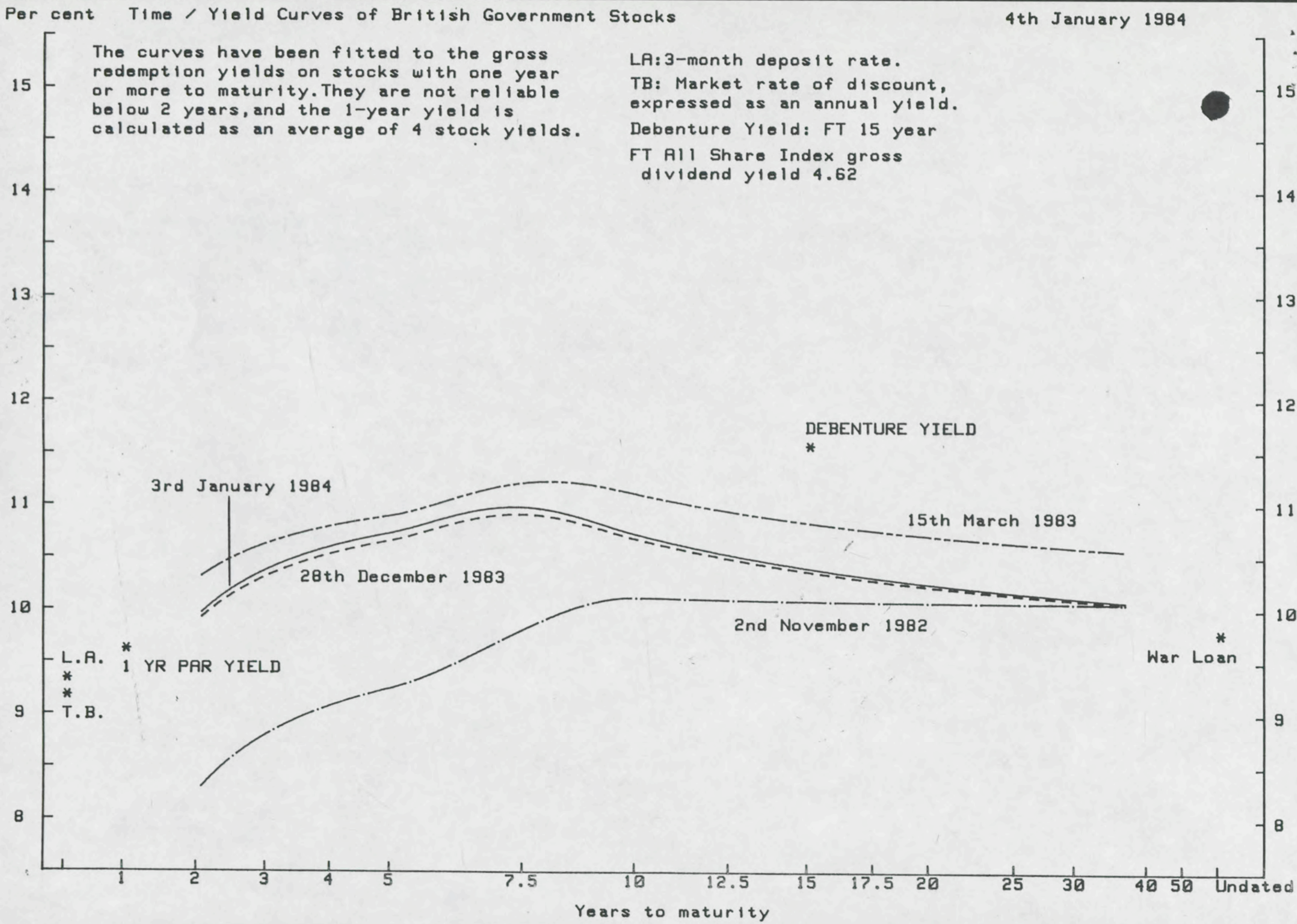
Gilt Yield Curves	**5 year**	**10 year**	**20 year**	**IG Yields 2% 1988**	**IG Yields $2\frac{1}{2}$ 2011**
Wednesday 16 November	10.643	10.565	10.180	3.46	2.97
Friday 2 December	10.698	10.617	10.228	3.61	3.02
Friday 16 December	10.951	10.938	10.492	3.58	3.08
Friday 30 December	10.702	10.711	10.251	3.72	3.09

INTEREST RATES 16 NOV. TO 30 DEC.



EXCHANGE RATE 16 NOV. TO 30 DEC.




Per cent
Time / Yield Curves of British Government Stocks
4th January 1984
The curves have been fitted to the gross redemption yields on stocks with one year or more to maturity.They are not reliable below 2 years,and the 1-year yield is calculated as an average of 4 stock yields.
LA:3-month deposit rate.
TB: Market rate of discount, expressed as an annual yield.
Debenture Yield: FT 15 year
FT All Share Index gross dividend yield 4.62
DEBENTURE YIELD
3rd January 1984
15th March 1983
28th December 1983
2nd November 1982
L.A.
T.B.
1 YR PAR YIELD
War Loan
15
14
13
12
11
10
9
8
1
2
3
4
5
7.5
10
12.5
15
17.5
20
25
30
40
50
Undated
Years to maturity